

Embracing Islamic Microfinance: Proposed Role of Mosque Institution in Malaysia in Providing *Qardhul Hasan* Microcredit

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Abstract: Qardhul Hasan is a unique instrument being offered by Islamic Financial Institution (“IFI”). However, this zero-returning financing that urges by Islam seem not get attention by the IFI. Malaysia that considered as the hub for Islamic Finance also showing the same attitude where there is almost no Qardhul Hasan financing offered by IFI. While it always been discussed and suggested that this unique instrument should be offered by IFI, the reality of its application and zero-return which is not favourable to IFI should not be denied. This research paper aims to propose the role of mosque institutions in providing Qardhul Hasan microfinance to the society. This paper recognizes the need for other institution other than IFI to not only promoting Islamic Finance but also help in poverty alleviation through providing Qardhul Hasan microfinance. Since mosque institution during the golden era of Islam being one stop centre not only to perform Ibadat but also for other affairs including finance, it is suggested that this institutions assuming additional role of providing Qardhul Hasan microfinance to the society. This paper will taking an overview of Qardhul Hasan based Islamic microfinance in other countries and will adapted the success story from each of this practices. Success story of Akhuwat Foundation in Pakistan for example will be studied and its practice, principles, guidelines and application will be applied to the new model of Islamic microfinance by mosque institution in Malaysia together with other success story of Qardhul Hasan based Islamic Microfinance across the globe. Guidelines (if any) from the integration of these practices it is suggested that mosque institution in Malaysia should assuming the role of providing Qardhul Hasan based microfinance to the society.

Key words: Islamic Finance • Microfinance • Microcredit • *Qardhul Hasan* • Mosque

INTRODUCTION

Among the primary goals of Islamic economic system are equitable distribution of income, socio economic justice and eradication of poverty [1]. To achieve these, Islamic Financial institution (IFI) becoming among the main agent that help towards the achievement. The emergence of Islamic finance for the past 50 years witnessed many Islamic finance products been offered by the bank. With the establishment of Mit Ghamr Saving Bank in Egypt in the early 1960s and followed by the rapid development and establishment of many IFI across the globe showing the acceptance of Islamic finance not only in Middle East but also other part of the world [2].

The main reason behind the rapid development of IFI is the prohibition of *riba*’ in Islam and Islamic banks becoming the alternatives for Muslims to avoid themselves from involved with *riba*’ that practiced by conventional bank. As an alternative to *riba*’, profit and loss sharing has been suggested as an ideal method of Islamic financing. This mode of financing is expected to help the achievement of Islamic economic system goals by removing the inequitable distribution of income and at the same time lead to an optimal resource allocation. However, to remove inequitable distribution of income and wealth, the majority of the poor group in the society needs to be supported by Islamic banks by providing them with microfinance. Despite Islamic banking has been widely accepted worldwide, this concept of microfinance

(financing for the poor) by Islamic banks was not well promoted and developed where most Islamic banks not provide financing to the poor [2]. Dusuki [3] mentioned that with the passage of time, the original idea of Islamic banking and finance as promoted by MitGhamr Saving Bank in Egypt to help in economic development, helping the poor and poverty alleviation not being the agenda anymore but rather dominated with profit maximization doctrine that focusing in serving the well-off clients while the poor left un-bankable. Worse more, the said profit and loss sharing not only not been promoted by Islamic banks but the trend shown that Islamic banks completely moved from profit and loss sharing to debt based financing [4]. [2] also highlighted that due to the lack of profitability, inherent risk posed by microfinance and widespread belief that the poor remained poor due to the lack of skills make Islamic banks not interested with microfinance.

Other than that, with regards to *Qardhul Hasan* (interest free loan or zero return loans) that considered as noble in Islam and can be regarded as one of the tools that can be used to achieve equitable distribution on income and wealth is not widely practiced by Islamic bank. As cited by Zainal *et al.* [4] from MohdAriffin and Adnan [5], in 2006 -2007, only 23.1% or 3 from 13 Islamic banks in Malaysia offering *Qardhul Hassan* products and the total amount only amounted less than 0.2% from the net financing of that particular year. This shown that in Malaysia specifically, *Qardhul Hasan* not really gets attention from the Islamic banks.

Realizing these issues where Islamic banks especially in Malaysia not really interested in providing microfinance to the poor due to the low profitability and low penetration of *Qardhul Hasan* based financing, this paper aims at suggesting other institution than banking institution to serve the poor by providing *Qardhul Hasan* microcredit. While microfinance has several product, this paper will focusing only on microcredit while at the same time suggesting the institution that exists even before the establishment of banking institution and has been the centre of Islam activities during the golden era of Islam, Mosque. Other than highlighting the potential of Mosque institution in providing *Qardhul Hasan* microcredit, this paper also will discuss several microcredit practice across the globe with the aim to find the best microcredit practices which later will be integrated in order to come out with a model that can be applied in Malaysia.

Related Literature

Microfinance: Microfinance started as an experiment in South Asia and Latin America and Bangladesh is best

known as the start of the microfinance with the establishment of Grameen Bank. Microfinance is a part finance that providing financial services including lending to the poor and low income people, accepting deposit and services of payment [6]. Obaidullah & Mohamed-Salem, [7] listed out several products under microfinance which consist of:

- Micro-credit
- Micro-equity
- Micro-saving
- Micro-transfer
- Micro-insurance

While microfinance has many products, this paper will only focus on microcredit where this product as mentioned by Nawai and Bashir [8] offering and focusing credit facility to the poor. Microcredit can be defined as a very small loan given to the poor to help them to enhance their standard of living where the loan will be used in productive activity [9]. Nawai and Bashir [9] characterized microcredit as:

- The loans are too small
- No collateral required
- Mostly have weekly payments
- Short term in nature
- Mostly for women and poor people who are not eligible to borrow from formal channel
- Interest rate usually high due to high cost

Obaidullah and Tariqullah [7] also discussed four (4) models of microfinance that have been practiced globally:

Grameen Bank Model: Founded by Dr. Muhammad Yunus, founder of Grameen Bank, Bangladesh and also the recipient of Nobel Peace Prize in 2006 [2]. This model target the poor where it mostly focusing of women group (due to the record that women loan repayment rate is higher than men loan repayment rate) that consist of five members that guarantee each other's loan. Amanah Ikhtiar Malaysia (AIM) is the early replication of this Grameen Bank model that offered *Shariah* compliant microcredit.

Village Bank Model: This model consists of an implementing agency that established banks in individual village and consists of thirty to fifty members. This agency provides loans to individual and it repaid in weekly basis for four months and the village banks will return the principal together with the interest/ profits to

the implementing agency. The bank performance in paying the loans in full was required to ensure the 'future' injection of capital. The bank also provide saving services where this savings also will be use as capital and considered as 'internal capital' while the amount injected by implementing agency considered as ' external capital. This model has been widely replicated in Africa and Latin America and Jabal Al-Hoss in Syria is an example of a successful replication of this model and *Shariah* compliant.

Credit Union: This model operates based on the mutuality concept where it is owned and operated by its members. The union operates as non-profit financial cooperative not only mobilize savings but also provide loans for productive purposes for its members.

Self-Help Groups: This model consists of groups where each group consists of ten to fifteen members that have homogenous income and pools together its member saving which later use for the purpose of lending. Similar like Village Banks model, external funds also acquired from external sources.

Rashidah and Faisal [10] stated that there is a large gap in demand and supply of microfinance. This shortage existed due to the low commitment from the banks to provide this poor and un-bankable group of people due to the low profitability [2] and lack of guarantee (Segrado, 2005; Kausar, 2013). This make the bank not only worry about the profitability but also the repayment rates

This dilemma of banking institutions however proven otherwise where through the 1980s and 1990s, history shown that the repayment rates of the borrowers were excellent and were better than the formal sectors in the developing countries and also willing to pay the interest rate that enabled the microcredit institution to cover their costs. These borrowers that involved with the experimental microcredit programs in Brazil, Bangladesh and a few other countries were consisted of poor women that involved with micro-business [11].

However, in Islamic microfinance, *riba* ' or interest that practices in the conventional microfinance is not desirable and should be removed [12] and its responsibility is not only profitability goals but should be more than that where maximization of social benefit should be the ultimate goals [11].

Qardhul Hasan: *Qardh* and *Qardhul Hasan* has been discussed by several scholars and article and even though some writers treating the terms differently, this paper will treating both term similarly and considering the proposed mosque institution as an alternative body to provide *Qardhul Hasan* microcredit to the poor, due to the noble nature of microcredit, *Qardhul Hasan* will be used for the entire paper. This is due to achieving the objectives of the research on the application of *Qardhul Hasan* in microcredit by mosque institution rather than arguing about the differences in the term used. However, it is imperative to know the meaning of both terms.

In Arabic, *qardh* literally means "cutting off" where the moneylenders actually cuts off some of his money when he lends his money to someone and *hasan* means beautiful or splendid where *Qardhul Hasan* means "beautiful loan" [7, 13]. According to ISRA (2011, p 304), the essence of *qard* based on the definition by AAOIFI *Shariah* Standard No.19 is providing loan to another party that will gain from the loan where the receiving party will utilize the loan and return back the same value.

Obaidullah [7] also stated that *Qardhul Hasan* is a loan that granted the lender with no expectation of any return from the principal and Abdul Rahman [2] simply define *Qardhul Hasan* as interest free loan. From these definitions, several characteristic of *Qardhul Hasan* can be summarized:

- One party (moneylender) lends the party with the aim to help the borrower.
- The borrower will received the benefit and can use the money for his purposes.
- The borrower needs to return back the money with the same value.
- No interest or addition charged for the use of the money.

Qardhul Hasan also being mentioned and highlighted in Al-Quran where it not only praised but the act of giving loan to the needy is like giving loan to Allah S.W.T. and Allah S.W.T will repaid back in multiple. The term multiple here is not referred to the interest since interest is prohibited in Islam but it referred to the reward that Allah will grant to the lender either in this world or in the hereafter or both. This can be referred to several Quranic verses:

“Who is it that will lend Allah a *qardhasan* which He will multiply for Him (the lender) many times and for him shall be a generous recompense” (Al-Quran, 11:57)

“Verily, those who give *sadaqa*, men and women and lend to Allah a *qardhasan*, it shall be increased manifold (to their credit) and theirs shall be an honorable good reward” (Al-Quran, 57:18)

“If you lend Allah a *qardhasan*, He will multiply it for you. Allah is the most appreciating, the most forbearing” (Al-Quran, 17:64)

These verses justify the noble nature of *Qardhul Hasan* where it not only will get reward from Allah S.W.T but also praised like giving *sadaqah*. The nature of *Qardhul Hasan* that have no interest further enhance it virtue in the view of Allah S.W.T since interest is prohibited and condemned in Islam. This concept of *Qardhul Hasan* also can be used in microfinance like suggested by Rahman, [2] where Islamic banks can provide interest free loan to microenterprise where Islamic banks only charge a service fee and bear the credit risk.

From all these definitions, *Qardhul Hasanis* a concept that highly recommended in Islam and can be used in microfinance. However due to its low profitability and no collateral, especially in Malaysia, from the study conducted by Islamic banks showing a low commitment. Mohd Ariffin and Adnan [9] (as cited by Ahmad *et al.* [4]) only 3 out of 13 Islamic banks in Malaysia offering *Qardhul Hasan* products in 2006 to 2007 and it only comprise of 0.2% from the net financing of that particular year. This trend is critical since Islamic banks that exist due to need of Muslim to run away from *riba'* only catering the needs of the well-off group while the poor remained un-bankable. However, we cannot blame Islamic banks since high risk associated with the microcredit where no collateral provide by the borrower and low profitability reduce the commitment from the Islamic banks to provide such products. This lead to the role of providing microcredit take over by the institution other than banking institution such as Microfinance Institution like Amanah Ikhtiar in Malaysia or foundation like Akhuwat foundation in Pakistan. Even though some initiative by banking institution like Mit Ghamr in Egypt and Grameen Bank in Bangladesh, this only limited to these few banks and as highlighted by Dusuki [3] where with the passage of time, the objectives of Islamic banks moved toward profit maximization doctrine that left the poor un-bankable.

Islamic Microfinance

Amanah Ikhtiar Malaysia (AIM): The history of AIM can be channeled back to the development of Grameen Bank in Bangladesh where the establishment of AIM was following the Grameen Bank model. The project started in 1986 with two Universiti Sains Malaysia staffs, Proff. David Gibbons and Prof. Madya Sukor Kasim initiated a project called Projek Ikhtiar which funded by Yayasan Pembangunan Ekonomi Islam Malaysia (YPEIM), Asia Pacific Development Centre (APDC) and Selangor State Government. This project aimed at measuring the suitability of implementing a microfinance program that based on Grameen Bank model and implemented in Northwest Selangor in its initial phase before further implemented in other region in Malaysia.

The Ikhtiar Project was developed to eliminate poverty group from the rural family in Malaysia with some adaptation of the Grameen Bank model [8]. The purpose of developing AIM is to give small loans depending on the customer's repayment ability, to poor households for financing their business activities, for the purpose in helping them to move our from poverty group (Ramli, 2001). Currently, almost 99 per cent of the members are women and the loans available are generally on short-term basis (between 25 to 150 weeks payback time [14].

AIM provides seven type loan schemes namely “i-Mesra”, “i-Srikandi”, “i-wibawa”, “i-sejahtera”, “i-Bestari”, “i-Penyayang”, “i-Emas”. Table I explain of each scheme and its details repayment.

Even though micro finance are popular method to finance small business enterprises but the Islamic microfinance is still in an early stages stage especially in Malaysia. Commercial banks offering Islamic microfinance services in Malaysia limit their products based on Bai-Al Inah concept, which is known for a controversial debt-based lending. Nevertheless the AIM objective is to give small loans to the poor group to eradicate the poverty and claims that its loans are based on Qard-Hasan (interest-free) principles, however, AIM imposes a 10% service charge on its loans [12].

Akhuwat Foundation: Akhuwat was derived from ‘mwakhaat’ or known as brotherhood. It was established in 2001 from the idea of a group of friends in Lahore Gymkhana. The idea was expressed due to the high interest rates of 20 percent on microfinance loan. With initial donation of ten thousand rupees from one person of this group of friends, Dr. Amjad Saqib, a philanthropist,

Table 1: Product of AIM

Scheme	Financing (RM)	Payment Period (Weekly)
"i-Mesra"	1,000-2,000	12, 25, 35, 50
	3,000 – 10,000 (max)	12, 25, 35, 50, 75, 100
"i-Srikandi"	12,000 – 20,000 (max)	12, 25, 35, 50, 75, 100, 125, 150
"i-Wibawa"	5,000 (max)	12, 25 weekly or monthly for six months or fullpayment. (mingguatausetiapbulanselama 6 bulanatausekaligus).
"i-Sejahtera"	1,000 – 2,000	12, 25, 35, 50
	3,000 – 10,000 (max)	12, 25, 35, 50, 75, 100
"i-Bestari"	1,000 – 2,000	12, 25, 35, 50
	3,000 – 5,000 (max)	12, 25, 35, 50, 75, 100
"i-Penyayang"	1,000 – 2,000	12, 25, 35, 50
	3,000 – 5,000 (max)	12, 25, 35, 50, 75, 100
"i-Emas"	2,000 (max)	12, 25, 35, 50

Source: <http://www.aim.gov.my/>

utilize the donation as an interest free loan. This first donation of ten thousand rupees later given to a poor widow as a loan. With the loan, she bought two sewing machines and set up a mini boutique at her house and managed to repay back the loan within the stipulated time; six months. This success later brought more donation to Akhuwat and these friends forming the first Board of Governors of Akhuwat and Dr. Amjad Saqib became the first Executive Director. [13, 15].

The initial idea of Akhuwat was not to be like today, but only to see potential of interest free microfinance. However, due to the increased donations from PKR 10,000 in 2001 to PKR 1.5 million in 2003, it was decided to formalize the institution and Akhuwat was registered in 2003 under Societies Registration Act of 1860. The first official branch of Akhuwat was opened at Township, Lahore.

The objectives of Akhuwat are as follow [15]

- To provide interest free microfinance services to poor families enabling them to become self-reliant.
- To promote qard-e-hasana as a viable model and a broad-based solution for poverty alleviation.
- To promote qard-e-hasana as a viable model and a broad-based solution for poverty alleviation.
- To provide social guidance, capacity building and entrepreneurial training.
- To institutionalize the spirit of brotherhood, compassion and volunteerism.
- To transform Akhuwat borrowers into donors.
- To make Akhuwat a sustainable, growth-oriented and replicable organization.

With main objective of providing interest free microfinance to poor families, Akhuwat chart a great

achievement in providing microfinance to poor. As at July 2016, PKR 28,276,804,342 was disbursed with recovery percentage of 99.93% and with outstanding loan of PKR 8,154,945,447. Other than the high percentage of repayment which signify the lower risk of repayment, total contribution that more than PKR 28 billion shows the willingness of people to donate and contribute. Interestingly, the one that donate was not limited to the public but also the borrowers.

Board of Directors: Akhuwat Board of Directors consisting of philanthropists, businessman and civil servants and the Board are responsible for internal governance. According to [13], other than reviewing operations and policy decision, the Board also responsible to mobilize funds for saving and provide marketing services for Akhuwat. Executive Committee (consisting of three members) meet will meet every 3 months for reviewing. The Head Office is responsible for allocating the credit while at the same time responsible for planning, managing and organizing activities of the organization.

Interesting part about Akhuwat Board is all the members work on honorary basis and not getting any salary. This also include many other voluntary workers including universities students.

Loan Types: According to [15], there 7 types of loan being offered to the people.

Family Enterprise Loan: For establishing a new business or expansion of the business. This type of loan comprising 91% of loan portfolio and can ranges from PKR 10,000 to PKR 30,000. However due to the rapid inflation in the country, Akhuwat gives initial loan of PKR 15,000.

Liberation Loan: This loan is for the repayment of loans with high interest rate. This loan offered by Akhuwat due to the culture of informal money lenders prevalent in Pakistan that charged as high as 1,000 %. In order to fight interest, Akhuwat give loans up to the principal amount of the loan and the borrower can pay by installment without any interest rate charged. The amount that can be borrowed can be up to PKR 50,000.

Marriage Loan: This loan is to facilitate the borrower in the marriages of their daughters. In Pakistan, it become the responsibility of the family to marry their daughters and this including the dowries and marriage ceremonies. For poor family, it become burden to them since it need huge sum of money. Maximum amount that can be borrow is PKR 20,000.

Health Loan: Health loan by Akhuwat complementing the health services provided Akhuwat to their employees, borrower and underprivileged. This loan is for the group of people who are unable to support the expensive cost of health care. The loan can range from PKR 10,000 to PKR 20,000.

Education Loan: In Pakistan, due to the insufficient fund to support their education, many students from poor family are forced to drop out of school. Since education has been integral part of Akhuwat's social agenda, this Education Loan was introduced. The limit of this loan is PKR 25,000.

Housing Loan: Housing Loan is for renovation of houses including the construction of walls, roof and rooms. Before the application approved, the purpose of renovation is measured by ensuring it for necessity and not for luxury. The loan range from PKR 30,000 to PKR 70,000 and must be paid within 2 years.

Emergency Loan: This loan intended for the diffusing the impacts of major crisis or contingencies. The loan can be used to diffusing losses in motor vehicle repairs, machinery repairs, health care expenses, business and veterinary expenses amongst others. This loan can ranges from PKR 5, 000 to PKR 10, 000 and may be repaid over one year.

Akhuwat Operation: As mentioned by Babar *et al.*, [13], the operation of Akhuwat started by all the Board members who saliently responsible for mobilize the fund. This fund will may come from various sources but one thing in common, it is coming from donation. The fund

then will be utilized by giving it as loan to the local. As Akhuwat have different branches across the country, each branch will only focusing on the local people near the Akhuwat branch. The loan disbursement process is as follow:

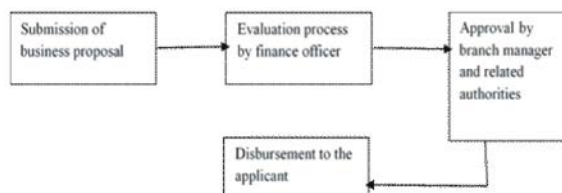


Fig. 1: Akhuwat Financing Operation Procedure

Submission: The applicant has to provide information about their economic status and also reason for the loan. For individual that wish to start a new business, they has to present the business proposal.

Evaluation Process: Unit Manager (loan officer) will perform evaluation by doing economic and social appraisal. Not only the applicant but also members and neighbor are interviewed. The loan preference is towards the applicants who fall under poverty line (head of the family income less than PKR 4,000). In order to secure the loan, relatives and neighbor will form a group of 3 to 6 members and act as guarantor of each other. This practice is a new procedure where before this the borrower need to find their own guarantor but due to the difficulty, Akhuwat introduced this group lending program.

Approval: Branch Manager will ensure the appraisal process conducted properly before referred to Loan Approval Committee comprises of the Unit, Branch and Area Manager. In this committee, Area Manger's opinion is taken due to his/her experience.

Disbursement: After approval, accounts office disburses the loan using cheques. The applicants together with their family members are called to a mosque or any religious location for the disbursement ceremony.

Mosque: Mosques is known as a place for the Muslims to perform prayers and religious activities. However the function of mosque in developing the communities and other crucial role have not been highlighted to the layman now days. In fact, Mosque are also known as a place for learning, economic development and welfare place during the Prophet ruling period. According to Rafi, [16] mosque usage are wide which can be a place for education centre, legal decision, welfare care centre to accommodate the

needy, travellers and perform marriage. However the limitation of mosque for community development are less emphasized, even though the establishment and frequent usage of mosque are based location of the community in that area.

In Malaysia, the establishment of mosques can be by the government initiative, housing developer or any private individual or group. Azhar [5] mentioned that main sources of fund for mosque come from the public donation even though there some fund allocation from the government and related authorities. In fact, there are certain mosques which have separated donation box for

the special month like Ramadhan, mosque committee and mosque operation in general. Even though the fund management will be done by the mosque committee through stringent and appropriate financial procedure [5, 17]. In fact according to Azhar [5], public has voice out that there are lack of efforts to invest the mosques' funds into more economic and productive activities. Therefore, this is an opportunity for the mosque to use certain amount of the donation fund by the public to be included in economic development from the mosque through microfinance using *Qardhul Hasan* concept.

Islamic Microfinance by Mosque:



Fig. 2: Proposed Islamic Microfinance using Qardhul Hassan concept

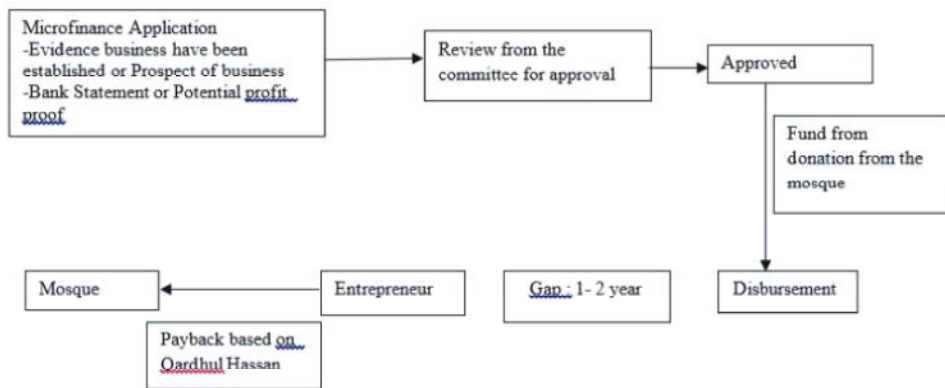


Fig. 3: Islamic Microfinance operation based on Qardhul Hassan

CONCLUSION

Mosque is an Islamic institution that play a great role for the society and economic development not only limited to religious activity only. Islamic microfinance practiced by the mosque in future can contribute to the society economy and community development in a productive way.

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